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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 388

THE UNITED STATES, PETITIONER

v.

HORACE HAVEMEYER

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims of the United States.

OPINION BELOW

The opinion of the Court of Claims (R. 17–28) is reported in 59 F. Supp. 537. The dissenting opinion of Judge Madden (R. 28–30) is also reported therein.

JURISDICTION

The judgment of the Court of Claims was entered on April 2, 1945. (R. 30.) Time for filing petition for writ of certiorari was extended to August 31, 1945, by order of this Court dated

June 16, 1945 (R. 32). The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

In determining the value of large blocks of stocks for federal gift tax purposes, the court below ignored the prevailing market prices of the same stocks upon the New York Stock Exchange and found values which were based upon an assumption that the market prices would have been depressed if the blocks had been thrown upon the market at the valuation date.

The question presented is whether the potential effect of such an assumed forced liquidation may properly be considered as a factor in valuing the securities.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved may be found in the Appendix, *infra,* pp. 16–23.

STATEMENT

The facts pertinent to the question presented here as found by the Court of Claims (R. 5–17) may be summarized as follows:

Respondent, a citizen and resident of New York, on November 19, 1934, made certain gifts to and in trust for the benefit of his four children. These included 160,000 shares of no par common stock of Great Western Sugar Company and

20,000 shares of no par common stock of South Porto Rico Sugar Company. Each of four different trusts received 40,000 shares of Great Western stock and 5,000 shares of South Porto Rico stock. (R. 5.)

Respondent's gift tax return reported the Great Western stock at a value of $28.125 a share in an aggregate total of $4,500,000 and the South Porto Rico stock at a value of $24.50 a share in an aggregate total of $490,000. These two stocks were listed on the New York Stock Exchange and the unit prices used in valuing the stock in the gift tax return represented the mean between the highest and lowest quoted selling prices upon the date of the gift. (R. 5–6.)

Both the preferred and common stocks of the Great Western Sugar Company were listed and traded upon the New York Stock Exchange. In 1932 the common stock had fallen to a depression low of something over $3 a share but thereafter staged a substantial recovery. Actual sales of Great Western common stock on the New York Stock Exchange by days, weeks and months appear in the record. (R. 10–11). On November 19, 1934, the record shows total sales of 2,500 shares at a high of $28\frac{3}{8}$ and a low of $27\frac{7}{8}$. Weekly sales for the week ending November 24, 1934, were 7,100 shares at a high of $28\frac{3}{8}$ and a low of $26\frac{3}{4}$. During the month of November 1934, 27,200 shares were sold at a high of $29\frac{3}{4}$ and a low of $26\frac{5}{8}$. The total value of the number of shares

of Great Western Sugar Company sold from January 1 to December 31, 1934, 653,400, computed upon the basis of the mean of the high and low prices for the year (30⅛), was $19,683,675. (R. 9–11.)

South Porto Rico Sugar Company common stock was listed and traded on the New York Stock Exchange. It had a 1932 depression low of $4.50 a share but had risen sharply thereafter. Actual sales of this common stock on the New York Stock Exchange appear by days, weeks and months in the record (R. 13–14). This shows 900 shares sold on November 19, 1934, at a high of $24⅞ and a low of $24¼; weekly sales for the week ended November 24, 1934, of 4,300 shares at a high of $24⅞ and a low of $24¼; and aggregate sales for the month of November 1934 of 18,200 shares at a high of $27 and a low of $23¼. The value of the total number of shares sold during the calendar year 1934, 224,200, based upon the mean of the high and low prices for the year (29 11/16), was $6,655,937.50. (R. 12–14.)

The proportion of the volume of trading in Great Western and South Porto Rico common stocks to their respective total outstanding shares compared favorably with the corresponding proportion of volume of trading in the Dow-Jones Industrials, and with the 10 most active stocks on the New York Stock Exchange on November 19, 1934, both on that date and for the year 1934. (R. 15.)

The markets for Great Western and South Porto Rico stocks on or about November 19, 1934, were reasonably good from the standpoint of volume of trading, free from misrepresentation or manipulation, and were free open markets where prices were determined by supply and demand. The prevailing prices of these stocks on the New York Stock Exchange on November 19, 1934, were fair prices for the volume of stock being traded on the market at that time. In general the buying public which was dealing in these stocks was fully informed as to all factors affecting their values and gave full effect thereto in the market prices prevailing on November 19, 1934. (R. 15.)

The donees of the separate gifts which plaintiff made on November 19, 1934, in the total amount of 160,000 of Great Western stock and 20,000 shares of South Porto Rico stock, did not sell these shares or any part thereof at or about that time or anywhere near that time. There is no evidence in the record that they ever offered all or any part of such stock for sale at any time, or that blocks of such stock of comparable size were offered for sale at one time at or about November 19, 1934. (R. 16.)

On November 19, 1934, an additional 160,000 shares of Great Western common stock or 20,000 shares of South Porto Rico common stock could not have been sold on the New York Stock Exchange without depressing the price. No element

of stock control prevailed with respect to the stock involved in this case, since the 160,000 shares of Great Western stock was equal to only 8.89% of the total shares outstanding, and the 20,000 shares of South Porto Rico stock was equal to only 2.68% of the total shares outstanding. (R. 16.)

The method of marketing the blocks of stock involved in this case which would have yielded the greatest return to a seller on November 19, 1934, would have been a sale to a group of investment bankers forming an underwriting syndicate for the purchase of the shares with the intention of reselling them to the public. Their price to the buying public would have been approximately $27.50 per share for the Great Western stock and $24 for the South Porto Rico stock. Their underwriting charge to the vendor for service and expense of selling would have amounted to two and one-half to three points on the former and two points on the latter. A seller could reasonably have expected to have received net approximately $25 per share for the Great Western stock and $22 per share for the South Porto Rico stock. (R. 16–17.)

Investment trusts, insurance companies, and financial institutions, which carry large blocks of listed stocks in their portfolios, ordinarily report to their stockholders and in their balance sheets the market value of such stocks on any given date at amounts obtained by multiplying the number

of shares owned by the prevailing market price on the exchanges on that date, regardless of the number of shares held. In some instances a further report is given by such companies to their stockholders of the estimated realizable value upon forced liquidation, which shows a discount from the market values just referred to on account of brokerage, transfer taxes, and blockage. (R. 17.)

The Court of Claims concluded that the fair market value on November 19, 1934, of the 160,000 shares of stock of Great Western was $25 a share, or $4,000,000; and the actual fair market value of the 20,000 shares of stock of South Porto Rico on November 19, 1934, was $22 a share, or $490,000. (R. 17.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the actual fair market values on November 19, 1934, of certain shares of Great Western Sugar Company and of certain shares of South Porto Rico Sugar Company stock were, respectively, $25 per share and $22 per share.

2. In failing and refusing to hold that such shares had a fair market value of $28.125 and $24.50, respectively, on November 19, 1934.

3. In holding that the applicable statute and Regulations permit the use of the so-called blockage method of valution of corporate stock in situations where, as here, the shares were held for

investment, were not sold and offered for sale, and the quoted market prices for such stocks on the New York Stock Exchange were fair prices for the volume of stock being traded on the market at that time in an amount which compared favorably with the reported trading in the Dow-Jones Industrials and ten most active stocks in the exchange.

4. In failing to follow the rule that where it is shown that there was a market in which like articles in volume were openly bought and sold, the prices current in such a market will be regarded as fair market value.

5. In relying solely on the facts that an additional 160,000 shares of Great Western common stock or 20,000 shares of South Porto Rico common stock could not have been sold on New York Stock Exchange without depressing the price as substantial justification for its rejection of the market prices as the proper criteria of the values.

6. In adopting criteria in conflict with the "willing seller and willing buyer rule" authoratively approved as the proper rule for determining equivalent values when reliable market prices are unavailable.

7. In relying on volume alone as a basis for the adoption of other criteria rather than on the principles that property of the same kind and use should be taxed on the same basis.

8. In adopting as the criteria the prices which might be offered by a dealer below the retail or

ultimate sales value which he expects to receive from the public and thus allowing reductions of hypothetical compensation to dealers for selling the shares.

9. In giving the word "value" the meaning of "estimated realizable value upon a forced liquidation."

10. In failing to enter judgment for the United States and failing to dismiss the petition.

11. In the alternative the court below misapplied the blockage theory and determined the value of blocks of 160,000 shares and 20,000 shares, respectively, and not the value of the separate gifts of blocks of 40,000 and 5,000 shares. Since there was no opinion evidence as to the value of the smaller blocks, the court below should have dismissed the petition for failure of proof.

REASONS FOR GRANTING THE WRIT

The basic question is whether a finding of value is to be predicated, as a matter of law, upon the amount realizable in a hypothetical forced liquidation. This is not only a question of law,[1] but a problem of fundamental importance in the administration of the federal gift and estate tax laws. The controversy involves a basic difference in views as to the ultimate place of the "blockage" theory in the field of valuation. The problem has provoked considerable litigation, and continues to hamper the administration of the fed-

[1] *Powers* v. *Commissioner*, 312 U. S. 259, 260.

eral gift and estate tax laws. During the 1941 Term, this Court denied the Government's petition for certiorari in *Helvering* v. *Maytag*, 316 U. S. 689, raising this issue. The problem, however, has not diminished in importance, and we are advised by the Commissioner of Internal Revenue that there are presently pending 156 gift and estate tax cases raising this issue, involving an aggregate of over $20,000,000.00 in taxes. The situation, involving as it does, principles of valuation, does not lend itself readily to statutory correction, and we respectfully urge that a final and authoritative decision would be in the public interest.

1. The rationale of the blockage argument, accepted by the court below to settle the controversy here, is that a large block of stock cannot ordinarily be marketed as readily as a few shares of the same stock; that whenever the number of shares to be valued is large in proportion to the volume of shares normally traded in upon an established market, then an offering of such a block would depress the market and consequently reduce the price which each share would bring; that the prevailing quoted market price for a particular stock actively traded in upon the New York Stock Exchange determined by supply and demand in a free, open, informed and active market undistorted by any abnormal conditions, although a fair price for the volume traded, is not a fair market price for such stock in quantities greater than the actual market volume at or about any particular

date; that the fair market value of such a block of stock for gift tax purposes is something less than the quoted unit market price times the number of shares to be valued, here approximately $3.125 less per share for the Great Western stock and $2.50 less per share for the South Porto Rico stock; that this discount may be based upon opinion evidence as to what might have been the result of an assumed sale even though no such sale was contemplated or was made at or about the material date; that it is proper not only to assume such a sale, but also to assume that the potential market supply could not be absorbed by any corresponding increase in market demand; and that this method of valuation for large blocks of stock is a proper method under the statute applicable in this case.

The court below found quoted market prices per share to have been determined by supply and demand in free, open, active and informed markets, undistorted by abnormal factors and fair prices for the respective quantities of each of the stocks which were being traded on the New York Stock Exchange. (R. 15.) Petitioner contends that this finding leaves nothing further for consideration in the determination of the values in question.[2]

The blockage theory conflicts with the established principle of law that fair market value or

[2] *United States* v. *New River Collieries*, 262 U. S. 341; cf. *Standard Oil Co.* v. *So. Pacific Co.*, 268 U. S. 146.

actual value of corporation stock is to be determined for tax purposes upon the basis of sales between willing buyers and willing sellers. Value may not be determined upon the basis of distress sales or forced liquidations. Yet this is precisely the effect of applying the blockage theory here. Except for the blockage theory, the prices for securities actively traded on the New York Stock Exchange would be accepted as the best evidence of value.[3]

The gift tax plan is one of graduated rates on cumulative gifts. The rates increase as the gifts become larger and, in computing the size, the gifts of prior years are added to those of a current year. Hence, one who makes twenty net gifts of $5,000 each pays the same tax as one who makes one net gift of $100,000. But if the decision of the court below is right and the value of 10,000 shares of stock is to be treated as something less than the sum of the values of ten lots of 1,000 shares each, the large gift carries a smaller rate than would the total of the smaller gifts. This, *pro tanto,* destroys the statutory plan and does so even though the donor has given away no less in one instance than in another.[4] More-

[3] Cf. *Hazeltine Corp.* v. *Commissioner*, 89 F. 2d 513, 519 (C. C. A. 3d); see also *W. T. Grant Co.* v. *Duggan*, 94 F. 2d 859, 861 (C. C. A. 2d); *Metropolitan Life Ins. Co.* v. *United States*, 65 C. Cls. 149, 163.

[4] Even if the blockage theory is to be applied here, the court below erred in lumping together the four separate gifts of 40,000 shares of Great Western and 5,000 shares of South

over, the decision below necessarily results in the anomaly that two shares of stock, each of which represents the same interest in the same corporate enterprise, may on the same date have different values for gift tax purposes simply because they are owned by different persons.

If the blockage theory is to be applied in the circumstances of this case, it may be doubted whether the Regulations apply to any gift of a block of shares aggregating more than the volume traded daily. Acceptance of the blockage theory will require taxpayers and administrative officers to litigate every issue going to the value of blocks of stock which exceed the daily volume of market trading, with the outcome dependent upon the acceptance or rejection of speculative opinions of witnesses. Thus the purpose of the Regulations will be frustrated. They establish a criterion of value which gives the statute efficient operation, administrative practicability, consistency, equality, and one which takes into account all of the elements of the value of property to a donor. The Regulations from 1933 to date are set forth in the Appendix, *infra*.

Porto Rico sugar, and determining value upon the basis of a single block of 160,000 shares of Great Western and a single block of 20,000 shares of South Porto Rico sugar. *Phipps* v. *Commissioner*, 43 B. T. A. 1010, 1022, affirmed, 127 F. 2d 214 (C. C. A. 10th), certiorari denied, 317 U. S. 645; *Avery* v. *Commissioner*, 3 T. C. 963, 971. See Specification of Error No. 11, *supra*, p. 9.

2. Several Circuit Courts of Appeals and the Tax Court have now held that the blockage theory properly may be applied in the valuation of stock for gift and for estate tax purposes.[5] Others have held that failure to apply the same theory, in circumstances not materially different from those presented here, is not error and that valuation based on market price is substantially supported.[6] The ultimate place of the blockage theory is still confused and unsettled. It has not been finally determined. *Phipps* v. *Commissioner*, 127 F. 2d 214, 216 (C. C. A. 10th), cer-

[5] *Groff* v. *Munford* (C. C. A. 2d), decided July 19, 1945 (1945 P-H par. 72,631); *Helvering* v. *Maytag*, 125 F. 2d 55 (C. C. A. 8th), certiorari denied, 316 U. S. 689; *Commissioner* v. *Shattuck*, 97 F. 2d 790 (C. C. A. 7th); *Helvering* v. *Kimberly*, 97 F. 2d 433 (C. C. A. 4th); *Helvering* v. *Safe Deposit & Trust Co. of Baltimore*, 95 F. 2d 806 (C. C. A. 4th); *Avery* v. *Commissioner*, 3 T. C. 963; *DuPont* v. *Commissioner*, 2 T. C. 246. See also *Rogers* v. *Helvering*, 107 F. 2d 394 (C. C. A. 2d), involving valuation of corporation stock for income tax purposes.

[6] *Mott* v. *Commissioner*, 139 F. 2d 317 (C. C. A. 6th); *Phipps* v. *Commissioner*, 127 F. 2d 214 (C. C. A. 10th), certiorari denied, 317 U. S. 645; *Bull* v. *Smith*, 119 F. 2d 490 (C. C. A. 2d); *Gamble* v. *Commissioner*, 101 F. 2d 565 (C. C. A. 6th), certiorari denied, 306 U. S. 664; *Richardson* v. *Helvering*, 80 F. 2d 548 (App. D. C.); *Roth* v. *Wardell*, 77 F. 2d 124 (C. C. A. 9th); *Allen* v. *Commissioner*, 3 T. C. 1224; *Estate of McKitterick* v. *Commissioner*, 42 B. T. A. 130; *Newberry* v. *Commissioner*, 39 B. T. A. 1123. See also *Hazeltine Corp.* v. *Commissioner*, 89 F. 2d 513 (C. C. A. 3d), and *Gordon, Trustee* v. *Commissioner*, 33 B. T. A. 460, involving valuation of corporation stock for income tax purposes.

tiorari denied, 317 U. S. 645. The dissenting opinion below demonstrates this. It is in the public interest that the situation be clarified by this Court.

CONCLUSION

This case presents a highly important fiscal problem. It warrants an authoritative ruling from this Court. It is, therefore, respectfully submitted that this petition for a writ of certiorari should be granted.

HAROLD JUDSON,
Acting Solicitor General.

AUGUST 1945.